STATE OF NORTH DAKOTA

BISMARCK, NORTH DAKOTA

REPORT OF EXAMINATION

OF

NODAK MUTUAL INSURANCE COMPANY
FARGO, NORTH DAKOTA

AS OF
DECEMBER 31, 2002

STATE OF NORTH DAKOTA

DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Nodak Mutual Insurance Company

Fargo, North Dakota

as of December 31, 2002, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal at my office in the City of Bismarck, this _____ day of _______________, 2003.

Jim Poolman
Commissioner of Insurance

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Fargo, North Dakota
June 17, 2003

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North Dakota Department of Insurance
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Commissioners:

Pursuant to your instructions and statutory requirements, a financial examination has been made of the books, records and financial condition of

Nodak Mutual Insurance Company
Fargo, North Dakota

Nodak Mutual Insurance Company, hereinafter referred to as the "Company," was last examined as of December 31, 1996, by the North Dakota Insurance Department.

SCOPE OF EXAMINATION

This examination was a financial condition examination conducted in accordance with N.D. Cent. Code § 26.1-03-19.3 and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook*. The examination was conducted to determine the Company’s financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. This statutory examination covers the period from January 1, 1997, to and including December 31, 2002, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

On September 23, 2002, the Company was placed under supervision by the Commissioner of Insurance of the State of North Dakota due to management instability and questions related to financial transactions with the North Dakota Farm Bureau. In conjunction with this examination and related to the Order of Supervision, the Examiners performed an extensive review of expense payments made by the Company to North Dakota Farm Bureau and its officers and obtained documentation of fees paid in other states under similar Farm Bureau - insurance company affiliations. The Examiners also considered the restrictions placed upon the Company in the Order of Supervision and documented in this report instances of noncompliance we noted while performing our regular audit procedures.

The North Dakota Insurance Department performed a separate market conduct examination of the Company covering the period from January 1, 2001, to December 31, 2001. The market conduct report was dated April 14, 2003.

Work papers provided by the Company's independent auditor, Meriwether, Wilson and Company, P.L.C., were reviewed and where deemed appropriate certain procedures and conclusions documented in those work papers have been relied upon and copied for inclusion into the working papers for this examination.

All recommendations made in the prior report of statutory examination have been adequately addressed by the Company with the following exceptions:

Recommendation	**Action by the Company**
It is recommended that the Company increase its fidelity bond coverage to the amount suggested by the NAIC *Examiners Handbook*.	The Company's fidelity bond coverage at December 31, 2002, did not meet the NAIC's suggested minimum amount of fidelity coverage.
It is recommended that the Company report the underwriting gain or loss on MPCI business on line 5 of the Statement of Income (page 4) of the Underwriting and Investment Exhibit.	During the period under examination, the Company continued to report the MPCI underwriting gain or loss under Part 3-Expenses as a reinsurance ceding commission.
It is recommended that the Company take the necessary steps to insure that all amounts reported in the statutory annual statement are adequately supported with detailed documentation of the items and amounts comprising the reported amount.	The December 31, 2002, detailed listing of unearned premiums did not agree with the balance reported in the 2002 Annual Statement.
It is recommended that the Company amend its agency agreement with Commercial First National Bank to include all of the safeguards and controls required by the NAIC *Examiners Handbook.*	The agreement in effect with Community First National Bank at December 31, 2002, does not contain the safeguards and controls recommended in the *Examiners Handbook*.

It is recommended that the Company submit forms for valuing Nodak Agency Incorporated with the SVO as required by N.D. Cent. Code § 26.1-03-02.1.	The Company did not submit the Nodak Agency, Inc. common stock for valuation with the SVO during the period under examination.
It is recommended that the Company report only amounts related to reinsured companies under the asset caption "Funds Held by or Deposited with Reinsured Companies."	The Company did not classify balances reported under "Funds Held by or Deposited with Reinsured Companies" in accordance with NAIC guidelines.
It is recommended that the Company amortize bonds purchased at a discount to the maturity date or call date producing the lowest value.	The Company amortizes bonds purchased at a discount to the call date rather than to the call or maturity date producing the lowest asset value.

This examination was conducted by Examiners from the North Dakota Insurance Department, representing the Midwestern Zone.

HISTORY

General

The Company was incorporated on April 15, 1946, under the laws of the State of North Dakota. The primary purpose for which the Company was formed was to make insurance contracts for all of the kinds of insurance specified in N.D. Cent. Code § 26.1-12-11.

Upon commencing operations on April 24, 1946, the Company took over the North Dakota division of the Iowa Farm Mutual Insurance Company. That division's membership, assets, and liabilities then became the basic structure of Nodak Mutual Insurance Company.

On November 20, 1975, the Company's legal term of existence was extended 30 years to November 20, 2005.

On March 31, 2001, The Dakota Companies, L.L.C., the Company's wholly owned subsidiary, acquired 100% of the issued and outstanding common stock of American West Insurance Company.

Board of Directors

The Bylaws provide that the Board of Directors shall consist of 12 persons who shall be a North Dakota Farm Bureau Board member and a current policyholder in good standing. Directors shall be elected at the Annual Meeting of the members. For the purpose of electing directors, the State of North Dakota is divided into nine districts defined in the Bylaws. Three directors are elected each year from each of three designated districts to serve for a term of three years. In addition to the nine directors, there will also be three directors, one of whom shall be the North Dakota Farm Bureau President, the YF&R Chairperson of the North Dakota Farm Bureau Board, and the Promotions and Education Chairperson of the North Dakota Farm Bureau.

Directors serving at December 31, 2002, were as follows:

Name and Address	Business Affiliations
Laurence T. Scheresky Des Lacs, ND	Farming
Jerry D. Jeffers Rhame, ND	Farming
John E. Heaton Driscoll, ND	Farming
James B. Engstrom Leeds, ND	Farming
Ken R. Lougheed Gardner, ND	Farming
Eric K. Aasmundstad Devils Lake, ND	Farming
Mark M. Owan Williston, ND	Farming
Sonya Gross Napoleon, ND	Farming
Doug C. Goehring Menoken, ND	Farming
Donald N. Uglem Northwood, ND	Farming
Russell D. Martinson Milnor, ND	Farming
Dennis R. Feiken LaMoure, ND	Farming

Officers

The Bylaws provide that the elected officers of the Company shall be a President, a Vice President and Executive Vice President, if needed, a Treasurer and one or more Assistant Treasurers, if needed, and a Secretary and one or more Assistant Secretaries, if needed.

Officers serving at December 31, 2002, were as follows:

Officer	**Title**
Douglas C. Goehring	President
Herbert F. Manig	Secretary
Gary H. Duncan	Treasurer
Eric K. Aasmundstad	Vice President

Conflict of Interest

The Company has an established procedure for the disclosure of possible conflicts of interest. Once a year, all directors, officers, and key employees are asked to complete and sign a conflict of interest questionnaire. The conflict of interest statements for the years 1999, 2000, and 2001 under examination were reviewed and no differences were noted. The Company could not locate conflict of interest statements for the years 1997, 1998, and 2002. **It is recommended that the Company's directors, officers, and key employees complete a conflict of interest statement on an annual basis and that the Company retain those statements for inspection for the years subject to examination**.

Articles of Incorporation and Bylaws

The Bylaws and Articles of Incorporation and all amendments thereto were read by the Examiners. Amendments adopted by the members during the period under statutory examination are described below.

Articles of Incorporation:

At the 1999 Annual Meeting, the membership approved Amended and Restated Articles of Incorporation.

Bylaws:

At the 1999 Annual Meeting, the membership approved the following amendment to the Bylaws:

- Article III, Section 1 was amended to increase, from 11 to 12, the number of directors who are members of the North Dakota Farm Bureau Board. The number of at large Directors was increased from two to three "one of whom shall be the North Dakota Farm Bureau President, the YF&R Chairperson of the North Dakota Farm Bureau Board, (and) the Promotions and Education Chairperson of the North Dakota Farm Bureau."

- Article IV, Officers, was amended to create a new Executive Vice President & CEO position and to modify titles of the Treasurer and the Assistant Treasurer.

At the 2000 Annual Meeting, the membership approved the following amendment to the Bylaws:

- Article II, Section 1, Membership Qualifications – A new provision was added expanding membership to "Residents of those states in which Nodak Mutual Insurance Company is licensed to conduct business as long as they are members in good standing, as defined by the Bylaws of the Farm Bureau affiliate organization within their respective resident state."

The Examiners noted the following with regard to the amendments to the Bylaws and Articles of Incorporation adopted during the period under examination:

- The Company did not file the 1999 and 2000 amendments to the Bylaws with the Department as required by N.D. Cent. Code § 26.1-12-05 and it did not pay the filing fees for amended Bylaws required by N.D. Cent. Code § 26.1-01-07(5).

- The Company gave an incorrect response to General Interrogatory #23 stating that it did not amend its Articles or Bylaws in years 1999 and 2000.

It is recommended that the Company file amendments to the Bylaws with the North Dakota Insurance Department as required by N.D. Cent. Code § 26.1-12-05, submit the proper filing fees required by N.D. Cent. Code § 26.1-01-07(5), and make the correct disclosures in the annual statement whenever it adopts amendments to the Bylaws or Articles of Incorporation.

Board of Directors and Policyholders Meetings

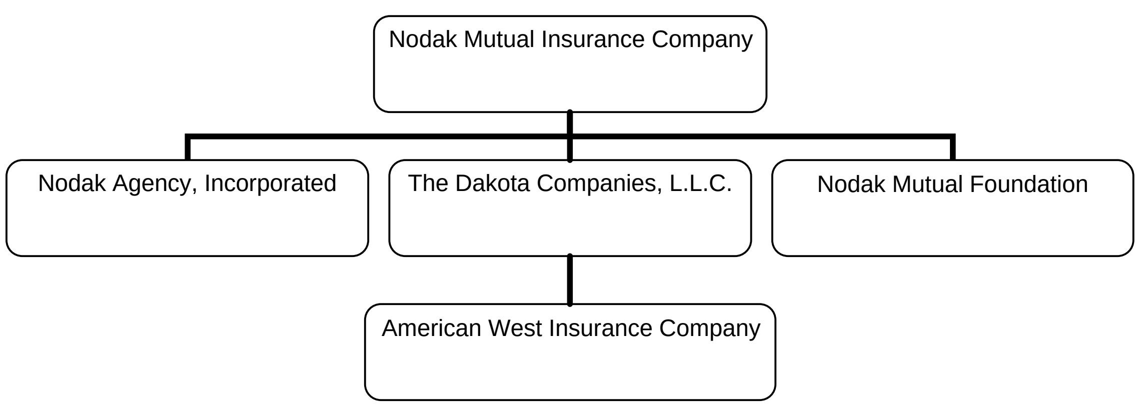
The minutes of the Board of Directors and policyholders for the period under examination were read.

The minutes of the various meetings indicate that meetings were well attended and held in accordance with the Bylaws.

AFFILIATED COMPANIES

General

The Company is a member of the following holding company system:



Nodak Agency, Incorporated (NAI) – NAI is a wholly owned subsidiary of the Company. It was incorporated in 1970 for the purpose of acting as a general agency to market lines of insurance not sold by the Company.

The authorized capital of NAI is $100,000, consisting of 1,000 shares of common stock with a par value of $100 per share. At December 31, 2002, 250 shares were issued and outstanding, all of which were owned by the Company.

NAI's Board of Directors is comprised of the same board members as that of the Company and the North Dakota Farm Bureau.

The common stock of NAI had a book value and fair value of $350,000 at December 31, 2002.

The Dakota Companies, L.L.C. (Dakota Companies) – The Dakota Companies was originally organized in 1998 for general business purposes. It owns 100% of the issued and outstanding shares of AWIC and leases assets to the Company and NAI for the benefit of their operations. Dakota Companies financed its acquisition of AWIC with a loan from Community First National Bank. On March 31, 2001, the Company entered into a guaranty agreement with Community First National Bank guaranteeing the indebtedness of Dakota Companies up to $8 million. At December 31, 2002, the balance of the loan was $6,570,000.

The carrying value of Dakota Companies at December 31, 2002, was $1,219,929.

American West Insurance Company (AWIC) – AWIC is a North Dakota domiciled insurance company licensed to do business in eight states. Dakota Companies acquired AWIC on March 31, 2001, from Tri-State Insurance Company, a wholly owned subsidiary within the Berkley Group. AWIC currently writes non-standard auto in North Dakota and commercial auto and property in Minnesota. AWIC wrote $1.9 million of direct business in 2002 and none in 2001. AWIC's surplus as regards policyholders was $6,320,180 at December 31, 2002.

Nodak Mutual Foundation – Nodak Mutual Foundation was formed in November 1999 as a wholly owned stock subsidiary of the Company for charitable, religious, and/or educational purposes.

AFFILIATED AGREEMENTS

Facility Services and Management Agreement

The Company and NAI are parties to a Facility Services and Management Agreement signed January 1, 2002. Payments to the Company in 2002 totaled $599,894 under this agreement. A summary of the agreement follows:

- NAI shall lease space from the Company at a rate the Company would charge itself to conduct normal business operations.

- NAI shall reimburse the Company for employees leased to NAI and for other expenses incurred by NAI to conduct its normal business operations. The amounts reimbursed to the Company by NAI will be determined based upon a direct charge, hourly rate, method of allocation, or some other method agreed upon by both parties.

Tax Allocation Agreement

The Company and AWIC file a consolidated federal income tax return pursuant to a written tax allocation agreement executed on March 7, 2002. Taxes incurred are allocated between the insurers based upon separate return calculations with current credit for net losses. The inter-company tax balances are to be settled annually in the first quarter of the year following the tax year.

Standard Leasing Agreement

The Company and Dakota Companies are parties to a Standard Leasing Agreement, effective June 1, 2001, that provides for vehicles and equipment owned by Dakota Companies to be leased to the Company. The annual rental consists of the total costs of fleet operation, administration, a 9.0% return on capital, and all other necessary expenses. Payments of $116,364 were made to Dakota Companies in 2002 under this agreement.

Management Service Agreements

Separate and similar Management Service Agreements between Dakota Companies and the Company, NAI and AWIC were executed in 2001 but have not been implemented as of December 31, 2002. Under the Agreements, the Dakota Companies was to become the employer and paymaster of all employees and agreed to provide executive, managerial, administrative, and human resource services in areas necessary to the business operations of the affiliated companies. The Company, NAI and AWIC agreed to provide data processing services, equipment, and other facilities to the Dakota Companies required in connection with its business operations. Since the agreement has not implemented, no payments were made in 2001 or 2002.

Employees of the Company performed underwriting, claims, accounting, administrative, and other services for its subsidiary, AWIC, in 2001 and 2002. The Company and AWIC did not enter into a management agreement and the Company did not charge for the services it provided to AWIC. N.D. Cent. Code § 26.1-10-05(1) requires that transactions between affiliates within a holding company system be fair and reasonable and that expenses incurred be allocated to the insurer in conformity with statutory accounting practices.

It is recommended that the Company and AWIC enter into a management services agreement and that the terms of the agreement comply with the standards contained in N.D. Cent. Code § 26.1-10-05(1).

OTHER RELATED PARTY AGREEMENTS

AFBIS Facilities Service Agreement

In June 1996, the Company entered into a Facility Services Agreement with American Farm Bureau Insurance Services, Inc. (AFBIS) pertaining to the regional office maintained by AFBIS in Fargo, North Dakota. The agreement contains the following terms:

- AFBIS will lease space from the Company commencing on October 1, 1995 and concluding on September 30, 2005, at rates varying from $11.00 per square foot to $13.00 per square foot during the lease period.

- AFBIS will reimburse the Company for employees and equipment leased to AFBIS.

- Settlements of the above charges will be made on a quarterly basis.

- AFBIS commits to maintaining a regional office in Fargo, North Dakota, for a period no less than 10 years.

Pursuant to a March 1998 Addendum, the original Agreement is extended to February 28, 2008, and a lease rate of $11.00 per square foot is specified from March 1, 1998, through February 28, 2003. Payments to the Company in 2002 totaled $227,884 under this Agreement.

County Farm Bureau Agreements

Insurance Service Office Agreements – These agreements were in effect through part of 1999 with each of the 50 County Farm Bureaus located in the State of North Dakota. The purpose of the agreements is threefold: (1) to coordinate the activities of the respective officers and personnel of each party within their respective areas of responsibility to increase member participation and understanding of the insurance program, (2) to adopt uniform standards for sound and efficient office insurance services for servicing policyholders, and (3) to strengthen the insurance program of the County Farm Bureau members to the mutual benefit of both parties. The agreements contain the following terms:

- County Farm Bureaus agree to provide office space and equipment necessary to carry on the acquisition and servicing of County Farm Bureau members who are policyholders of the Company.

- County Farm Bureaus shall maintain an administrative fund to pay expenses of services provided.

- The Company shall contribute to the administrative fund the following percentage of premiums collected:

  2 ½ % of the first million dollars in automaster premiums
  1 % of automaster premiums in excess of one million dollars
  2 % of premiums from the farm and ranch, roadmaster, homeowners and other lines of business

  If the calculated override commission is less than $700, the Company will contribute the balance to bring the monthly override payment to $700 per month.

- The Company shall also contribute to the administrative fund a commission payment on earned crop hail premiums based on loss ratio. If the Company's loss ratio is less than 55% for three of four consecutive years, a commission payment of 1% will be paid to the County Farm Bureau.

- The Company will pay a monthly royalty fee of $100 to each County Farm Bureau that is to be placed in the Farm Bureau Services Fund to be used at the discretion of the County Farm Bureau Board of Directors.

The Insurance Office Service Agreements with each County Farm Bureau were terminated at various times during 1999, except for the $100 per month royalty fee which the Company continued to remit through September 30, 1999.

As the County Farm Bureau agreements were terminated, the Company entered into Agent Office Agreements which provided for an office expense commission paid to the agent for the operation of an office based on the agent's earned premium. Effective March 1, 2000, the provisions of the Agent Office Agreements were integrated into the agent contracts and the office expense commission was converted to a three percent (3%) increase on new and renewal commissions on all the Company's products.

Office Lease Agreements – Following the termination of the Insurance Office Service Agreements, the Company entered into lease agreements with the County Farm Bureaus of Grand Forks, Ramsey, Walsh, and Ward Counties for the purpose of operating claims adjusting offices within the premises owned by the County Farm Bureaus. Three of these leases also provide that the Company reimburse the County Farm Bureau for claims support services. Payments of $210,658 were made to the County Farm Bureaus in 2002 under these office lease agreements.

North Dakota Farm Bureau Agreements

The Company and the North Dakota Farm Bureau (Farm Bureau) have been parties to various service and royalty agreements during the period under examination. These agreements are summarized as follows:

Service Agreement – This Agreement with the Farm Bureau, dated October 1992, contains the following significant terms:

- In consideration of services provided by Farm Bureau, the Company agrees to pay to Farm Bureau 1% of its annual earned premium. This amount shall be payable in 12 monthly installments based on the Company's fiscal year. Earned premiums include all business except multiple peril crop insurance and assumed business.

- Farm Bureau shall rent 2,266 square feet of space at the Company's home office at the rate of $7.00 per square foot for the main floor and 350 square feet in the basement at the rate of $6.00 per square foot.

- The Company shall pay 50% of personnel costs and travel expenses of a regional representative staff consisting of five full-time people. The Company shall also pay for various expenses including 50% of lodging and meals for the annual county Secretaries/Presidents Conference, contribution toward costs of Farm Bureau Youth Programs, Dakota Family Magazine advertising, 50% of mileage incurred by Farm Bureau state committee members, and 50% of actual expenses of the Farm Bureau Board of Directors for time and services rendered.

- Farm Bureau will reimburse the Company for printing costs, office supplies, and a shared receptionist.

- The Company will provide computer time for maintenance of membership lists and printing of dues notices and membership lists without charge.

Facility Services Agreement – This Agreement between the Company and the Farm Bureau is not dated and does not specify an effective date; however, it appears to have been executed in the late 1990s. The Agreement contains the following terms:

- The Farm Bureau will lease space from the Company for the sum of $1 per square foot and other consideration not enumerated.

- Additional charges for rent, print shop and copier services, UPS services, postage, telephone, group health insurance claims, lunch room use, and shared receptionist will be reimbursed to the Company at actual cost.

- The Company will reimburse Farm Bureau for joint board meeting expenses, advertising in the Dakota Family magazine, and other expenses not listed but necessary to conduct normal business operations.

- The Company is responsible for providing space, equipment and any other services, benefits, or needs of Farm Bureau employees located in the leased space.

The Examiners noted that the 2002 rental rate paid by the Farm Bureau was $11.00 per square foot for the 1st floor offices and $6.75 per square foot for the basement office in the Company's home office building.

Royalty Agreement – This Agreement was originally entered into with the Farm Bureau on January 1, 1999, and subsequently amended and restated on October 1, 1999. The initial Agreement allows the Company and Nodak Agency to use the Farm Bureau name, logo and other intangible benefits in exchange for an annual royalty of 2% of premiums earned in the previous year adjusted for premiums and losses assumed through reinsurance contracts. The royalty provisions were amended effective October 1, 1999, as follows:

- The Company shall pay the Farm Bureau an annual royalty of $50,000.

- Nodak Agency shall pay the Farm Bureau an annual royalty of 2% of agents' commissions and a fee ranging from $1.50 to $3.00 for each Blue Cross policy in force as to Nodak Agency's insureds.

The Royalty Agreement supersedes all other agreements between the parties to the extent said agreements are contrary to the provisions of the Royalty Agreement. The termination date of the Royalty Agreement is December 31, 2004.

Support Services Agreement – This Agreement was entered into with the North Dakota Farm Bureau Trade Development and Service Corporation ("FB Trade Development") effective January 1, 1999. Pursuant to this Agreement, FB Trade Development will provide the Company with support services including office space, lobbyists, clerical and administrative support, safety coordinator, member field services and member communications. The Company will pay an annual service fee equal to 2% of its earned premium, less $50,000. The Agreement provides for a term from January 1, 1999, through September 30, 2000.

Payments made during the examination period pursuant to the above service and royalty agreements with Farm Bureau-related entities are summarized in the following table. Also shown in the table are payments made to the Company's Directors for per diem and travel expenses related to board meetings and other Company activities.

	2002	2001	2000	1999	1998	1997
Insurance Service Office Agreement – County Farm Bureau						
Payments to County Farm Bureaus (% of premiums) *				$1,399,503	$1,110,948	$984,872
Services Agreement/Facilities Services Agreement – ND Farm Bureau						
a. Payments to Farm Bureau for 1% Earned Premium Fee				$82,981	$481,507	$486,421
b. Payments to Nodak for rent, telephone, postage, copying, receptionist and misc.	$61,134	$49,636	$52,094	$53,248	$38,187	$44,328
c. Payments to Farm Bureau to reimburse for the following:						
BOD expenses	$ 287	$ 3,839	$ 3,465	$ 9,709	$ 9,071	$ 5,752
First Care expenses				3,646	16,959	18,500
AFBF Annual Meeting	1,794	1,271	2,061	256	700	
District Committee Meetings				481	3,722	7,202
Annual Meeting	7,577	6,813	4,973	3,687	5,522	13,031
Miscellaneous	1,012	9,696	2,085	737	5,562	10,134
Copier				23,561	40,034	41,431
Advertising			600	2,400	3,350	9,320
Secretary Conferences					2,473	2,899
Reimbursement Subtotal	$10,670	$21,619	$13,184	$44,477	$87,393	$108,269
Royalty Agreement – ND Farm Bureau						
a. Payments to Farm Bureau by Company **	$50,004	$50,004	$50,004	$640,913		
b. Payments to Farm Bureau by Nodak Agency	$7,238	$5,972	$5,782	$6,013	$6,749	$7,200
Support Services Agreement – FB Trade Development						
Payments to FB Trade Development **	$749,804	$672,448	$646,875	$59,607		
Company's Board of Directors						
Payments to Directors for per diem and travel expenses	$54,940	$18,915	$25,426	$60,167	$41,369	$32,210

* The 1999 amount includes payments to agents under the Agents Office Agreements.

** The 2002 amounts include a $12,501 payable to Farm Bureau and a $187,451 payable to FB Trade Development that were suspended by the Insurance Commissioner pending the Department's investigation.

The examiners noted the following exceptions pertaining to the Agreements with Farm Bureau entities:

- The Facilities Services Agreement with Farm Bureau does not specify the annual rental fee to be paid the Company. The Agreement also requires the Company to reimburse for "other expenses not listed" and to provide "equipment and any other services, benefits, or needs of Farm Bureau employees located in the leased space" without specifying the exact nature of the expenses and services or an amount of consideration to be paid for such services. These provisions do not comply with the fair and reasonable standard required for related party transactions involving services under SSAP No. 25 and Appendix A-440 of the NAIC's *Accounting Practices and Procedures Manual*.

- Employees of the Company performed services for Farm Bureau during the period under examination involving collection of delinquent Farm Bureau membership fees. Such services are not specified in the Facilities Services Agreement and the Company did not charge Farm Bureau for these services.

- The Support Services Agreement specifies that the Company will pay to FB Trade Development an annual service fee equal to 2% of its earned premium, less $50,000. The actual payments remitted by the Company reflect "2% of premiums earned in the previous year adjusted for premiums and losses assumed through reinsurance contracts," less $50,000, as the basis for the service fee computation which does not adhere to the language of the Agreement.

- The Support Services Agreement specifies a termination date of September 30, 2000; however, payments continued to be made under the agreement after the termination date.

- The Farm Bureau entities meet the definition of related parties as provided in the NAIC's *Accounting and Practices and Procedures Manual*, SSAP No. 25, paragraph 2. SSAP No. 25, paragraph 17, requires disclosure of all material related party transactions. The aggregate of all transactions between the members of the Nodak holding company system and the Farm Bureau entities is deemed to be material and subject to the disclosure requirements of SSAP No. 25. The Company did not disclose its transactions with Farm Bureau entities under Note 10 of the Notes to the Financial Statements in its 2001 and 2002 Annual Statements.

It is recommended that the Company modify the Facilities Services Agreement with Farm Bureau to specify all services and related consideration to be paid, in compliance with the requirements for related party transactions under SSAP No. 25 which indicate that amounts charged for services must be fair and reasonable.

It is recommended that the Company review all related party transactions for consistency with and adherence to the terms of existing legal agreements.

It is recommended that the Company comply with the disclosure requirements of SSAP No. 25 by properly completing Note 10 of the Notes to the Financial Statements in the Annual Statement.

FIDELITY BOND AND OTHER INSURANCE

The Company is insured by a commercial blanket bond providing $100,000 coverage for each employee and by a blanket position bond providing $250,000 coverage for the position of Treasurer. The amount of fidelity coverage recommended in the NAIC *Examiners Handbook* is $700,000 to $800,000. **It is recommended that the Company increase its fidelity bond coverage to the amount suggested by the NAIC.**

Other insurance coverage covering the Company appeared adequate.

PENSION AND INSURANCE PLANS

Employee Benefit Plan

All qualified full-time employees are provided with group life insurance, accidental death and dismemberment, and comprehensive medical expense.

Employee Retirement Plan

The Company has a defined contribution pension plan covering substantially all employees with 12 months of service. A summary of the retirement plan follows:

- The Company is the retirement plan administrator.
- The retirement plan is available to full-time employees on the January 1 or July 1 entry date immediately following the later of the date on which an employee has completed 1 year of service or attained the age of 21. The employee becomes fully vested after five years.
- The Company is allowed to contribute 10% of each participant's compensation to the retirement plan.
- Normal retirement age under the retirement plan is age 65.
- Plan costs are fully funded as they accrue. The Company's total contribution for the defined contribution plan was $329,918 for 2002 and $343,244 for 2001.

401(k) Plan

The Company also sponsors a 401(k) plan with an automatic contribution to all eligible employees and a matching contribution for eligible employees with a 50% match up to 3%. The Company's total contribution for the 401(k) plan totaled $187,701 for 2002 and $197,150 for 2001.

STATUTORY DEPOSITS

The Company maintained the following deposits at December 31, 2002:

Location	Type of Assets	Statement Value	Fair Value
North Dakota	Bonds	$2,758,128	$2,964,737

The bonds are held in a trust account in Community First National Bank pursuant to deposit requirements set forth in reinsurance agreements.

The Company did not complete Schedule E, Part 2, Special Deposits in conformity with Annual Statement instructions. The following exceptions were noted:

- The line numbers OT00001 through OT99998 should be for special deposits held by an individual, a particular company, or to satisfy a particular claim or litigation. The Company did not use the "OT" prefix.

- The Company did not include the bond rate in the "Description of Deposit" column.

It is recommended that the Company complete the Annual Statement with attention to all detailed instructions.

INSURANCE PRODUCTS AND RELATED PRACTICES

At December 31, 2002, the Company was licensed to transact business in the States of North Dakota and Minnesota. The Company's business is solicited through approximately 70 exclusive agents. The Company writes primarily personal auto coverages, homeowners, farmowners, crop-hail, and multiple-peril crop insurance (MPCI) coverages.

Effective July 1, 2002, the Company and American Farm Bureau Insurance Services, Inc. (AFBIS) entered into a Multiple Peril Crop Insurance Partial Service Agreement. Under the agreement, AFBIS agrees to perform various services for the Company including the following:

- Perform all underwriting and claims data entry.

- Bill each policyholder directly, on behalf of the Company, for payment of the premium, interest and miscellaneous charges and/or fees due for each policy.

- Hold all funds collected for the Company in a fiduciary capacity in a bank which is a member of the Federal Reserve System.

- Perform all accounting functions and furnish monthly reports to the Company.

In return the Company agreed to pay AFBIS a service fee of 5.6% on all gross and imputed processed premium and .0025% for development of the E-commerce process.

It is recommended that the Company make the following disclosures in its Annual Statement with respect to multiple peril crop insurance (MPCI) and the MPCI Partial Service Agreement with AFBIS:

- **Report the unearned premium reserve associated with the multiple peril crop insurance program under Note 20 in the Notes to the Financial Statements as required by SSAP No. 78, paragraph 10.**

- **Report the amount of administrative expense payments received from the FCIC under Note 20 in the Notes to the Financial Statement as required by SSAP No. 78, paragraph 15.**

- **Report the direct premium written through AFBIS, a third party administrator, under Note 19 in the Notes to the Financial Statements.**

REINSURANCE

<u>Ceded</u>

The Company ceded reinsurance premiums totaling $21,559,215 in 2002 and as of December 31, 2002, had loss and loss adjustment expense reserve credits for ceded business totaling $8,253,853. Of the reinsurance premiums ceded, $11,978,856 represented reinsurance premiums for MPCI business ceded to the Federal Crop Insurance Corporation (FCIC). The remaining reinsurance premiums represented business ceded to American Agricultural Insurance Company.

A summary of the significant ceding agreements in effect at December 31, 2002 is as follows:

1. Title: Multi-Line Excess of Loss

Reinsurer: American Agricultural Insurance Company

Scope: Fire, allied lines, multi-peril policies, inland marine, and auto

Coverage:	Other Property	$650,000	excess of	$100,000
	Farm and Ranch	$600,000	excess of	$150,000
	Liability	$11,500,000	excess of	$300,000

Premium: Other Property 3.953%
Farm and Ranch 3.271%
Liability: Scheduled rates per layer ranged from 3.77% to .02%

Commissions: None

Termination: Either party at any calendar year end by providing not less than 90 days written notice.

2. Title: Umbrella Liability

Reinsurer: American Agricultural Insurance Company

Scope: Liability

Coverage: $15,000,000 million excess of $1,000,000

Premium: Quota Share

Commissions: 22.5% to 35%

Termination: Either party at any calendar year end by providing not less than 90 days written notice.

3. Title: Occurrence Property and Auto Catastrophe

Reinsurer: American Agricultural Insurance Company

Scope: Fire, Allied Lines, Farmowners (property perils), Homeowners (property perils), Commercial Multiple Peril (property perils), Inland Marine, Auto Physical Damage, Earthquake

Coverage: 95% of $21,052,632 ($20,000,000) excess of Company's retention which is equal to 5% of subject net earned premiums.

Premium: 10.416% of subject net earned premium

Commissions: None

Termination: Either party at any calendar year end by providing not less than 90 days written notice.

4. Title: Aggregate Property & Auto Catastrophe

Reinsurer: American Agricultural Insurance Company

Scope: Fire, Allied Lines, Farmowners (property perils), Homeowners (property perils), Commercial Multiple Peril (property perils), Inland Marine, Auto Physical Damage, Earthquake

Coverage: Layer 1: 90% of $2,222,222 ($2,000,000) excess of Company's retention which is equal to 31% of subject net earned premiums.

Layer 2: 50% of $3,333,334 ($1,666,667)

Premium: 6.314% of subject net earned premium

Commissions: None

Termination: Either party at any calendar year end by providing not less than 90 days written notice.

5. Title: Property Surplus Share

Reinsurer: American Agricultural Insurance Company

Scope: Fire, Allied Lines, Farmowners (Property Perils), Homeowners (Property Perils), Commercial Multiple Peril (Property Perils), Inland Marine Auto Physical Damage, Earthquake

Coverage: The Company cedes risks above a $750,000 retention to capacity of $40,000,000.

Premium: Scheduled

Commissions: 22.5% commission on the second and third surplus layer.

Termination: Either party at any calendar year end by providing not less than 90 days written notice.

6. Title: Proportional Crop Hail

Reinsurer: American Agricultural Insurance Company

Scope: Crop Hail

Coverage:

Layer	Percent Ceded	Capacity
Quota Share	46%	$130,000
Special Quota Share	14%	$130,000
1st Surplus	90%	$300,000
2nd Surplus	100%	$1,000,000
3rd Surplus	100%	$1,500,000

Premium: Scheduled

Commissions: None

Termination: Either party at any calendar year end by providing not less than 90 days written notice.

Assumed Reinsurance

The Company assumed reinsurance premiums totaling $4,058,346 in 2002 and as of December 31, 2002, had loss and loss adjustment expense reserves for assumed business totaling $1,928,415. Of the reinsurance premiums assumed, $2,522,000 represented reinsurance premiums assumed from American Agricultural Insurance Company. Most of the business assumed from American Agricultural Insurance Company represented assumptions from pooling arrangements. A summary of the significant assumption treaties follows:

1. Type: Occurrence Property and Auto Catastrophe Pool Retrocession Agreement

Reinsured: American Agricultural Insurance Company

Scope: Business assumed by American Agricultural Insurance Company from affiliated companies under Occurrence Property Catastrophe and Occurrence Property and Auto Catastrophe Reinsurance.

Coverage: The Company's participation ranged from 1% to .75% for six layers of coverage.

Termination: Either party at any calendar year end by providing not less than 60 days written notice.

2. Type: Proportional Crop Hail Pool Retrocession Agreement

Reinsured: American Agricultural Insurance Company

Scope: Business assumed by American Agricultural Insurance Company from affiliated Farm Bureau companies on Proportional Crop Hail business.

Coverage: The Company's participation in the basic pool was equal to 90% of premium ceded divided by total pool premium. The Company's participation in the 1st, 2nd, and 3rd surplus layers was 3%.

Termination: Either party at any calendar year end by providing not less than 60 days written notice.

3. Type: Quota Share

Reinsured: American West Insurance Company

Scope: Multi-line

Coverage: 90% of losses

Termination: Either party at any December 31, by giving no less than 120 days written notice.

The reinsurance agreements contain the insolvency clause required by N.D. Cent. Code § 26.1-02-21 and all of the required clauses set forth in the NAIC's *Accounting Practices and Procedures Manual* except for the "entire contract" clause. **It is recommended that the Company amend its reinsurance agreements by adding the "entire contract" clause to all agreements to which the Company is a party.**

On or about November 27, 2002, the Company send a Provisional Notice of Cancellation to American Agricultural Insurance Company ("American Ag") for the purpose of canceling its reinsurance contracts with American Ag. The Order of Administrative Supervision issued on September 23, 2002, prohibits the Company from entering into a new reinsurance agreement or modifying an existing reinsurance contract without the prior approval of the Supervisor appointed by the Commissioner. The Company did not advise the Supervisor it filed a Provisional Notice of Cancellation nor did it obtain prior approval from the Supervisor to cancel its reinsurance contracts with American Ag. In 2003, the Company renewed its reinsurance agreements with American Ag without substantial modification from the reinsurance program in place during 2002.

ACCOUNTS AND RECORDS

The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the course of the examination and a trial balance as of December 31, 2002, was extracted from the general ledger and traced to the appropriate schedules of the Company's 2002 Annual Statement. Revenues and expenses were test checked to the extent deemed necessary.

The Company is audited annually by an outside firm of independent certified public accountants. The work papers of this firm were made available to the Examiners and were used to an extent deemed appropriate for this examination.

The Company uses Freedom software for general ledger and accounts payable processing. At December 31, 2002, the Company used a FiServ program to process its auto business and an in-house program to process most of its other lines of business. The Company is in the process of converting all of its business to the FiServ program.

In some instances, notably unearned premiums, detailed listings did not always agree to annual statement balances. **It is again recommended that the Company retain or be able to recreate detailed listings that agree with amounts reported in the Annual Statement.**

EDP ENVIRONMENT AND APPLICATIONS

The Company's electronic data processing (EDP) environment was reviewed by the Examiner to determine whether appropriate general and applications controls were in place. The Examiner's findings are noted as follows:

- The Company has not tested its disaster recovery plan since 1999.

It is recommended that the Company test its disaster recovery plan in 2003 and thereafter a test of the Company's disaster recovery plan should be performed at least every 18 months.

FINANCIAL STATEMENTS

The financial statements of the Company are presented on the following pages in the sequence listed below:

Statement of Assets, Liabilities, Surplus and Other Funds, December 31, 2002
Underwriting and Investment Exhibit, For the Year Ending December 31, 2002
Reconciliation of Capital and Surplus, January 1, 1997 through December 31, 2002
Analysis of Examination Changes

Nodak Mutual Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 46,643,324		$ 46,643,324
Common Stocks	7,750,810		7,750,810
Real Estate:			
Properties Occupied by Company	2,248,700		2,248,700
Properties Held for Production of Income	292,590		292,590
Cash	418,998		418,998
Other Invested Assets	1,219,929		1,219,929
Agents' Balances or Uncollected Premiums:			
Premiums and Agents' Balances in Course of Collection	138,350		138,350
Premiums Booked but Deferred and Not Yet Due	7,845,024	$ 140,145	7,704,879
Accrued Retrospective Premiums	376,412		376,412
Reinsurance recoverables on Loss and Loss Adjustment Expense Payments	454,153		454,153
Federal Income Taxes Recoverable (including $1,831,883 Net Deferred Asset)	2,281,883		2,281,883
Electronic Data Processing Equipment	189,442		189,442
Interest, Dividends and Real Estate Income Due and Accrued	721,734		721,734
Other Assets Nonadmitted	2,019,315	2,019,315	
Crop Insurance Notes	409,683	409,683	
Non-sufficient Funds\Leasehold Impr	75,145	75,145	
County Loan\Assigned Claims\Misc.	125		125
Receivable from American Farm Bureau Insurance Services	1,038,528		1,038,528
Misc. Receivables	19,118		19,118
Totals	$ 74,143,263	$ 2,644,288	$ 71,498,975

Nodak Mutual Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
December 31, 2002

	Liabilities
Losses	$16,016,832
Loss Adjustment Expenses	3,239,000
Commissions Payable	850,208
Other Expenses	961,568
Taxes, Licenses and Fees	444,043
Unearned Premiums	19,770,812
Advance Premiums	1,296,727
Ceded Reinsurance Premiums Payable	1,188,382
Funds Held by Company under Reinsurance Treaties	472,054
Amounts Withheld of Retained by Company	4,282
Remittances and Items Not Allocated	1,058,132
Payable to FCIC	2,358,856
Payable to ND Farm Bureau	199,953
Total Liabilities	$ 47,860,849
Surplus as Regards Policyholders	23,638,126
Total Liabilities and Surplus	$ 71,498,975

Nodak Mutual Insurance Company
Underwriting and Investment Exhibit
For the Year Ending December 31, 2002

Underwriting Income		
Premiums earned		$ 47,226,480
Less:		
Losses incurred	$ 31,876,122	
Loss expenses incurred	4,155,265	
Other underwriting expenses incurred	17,191,403	
Total underwriting deductions		$ 53,222,790
Net underwriting gain (loss)		(5,996,310)
Investment Income		
Net investment income earned	$ 2,580,387	
Net realized capital gain (loss)	(83,892)	
Net investment gain (loss)		2,496,495
Other income		
Finance and service charges		5,520
Miscellaneous Income		145,680
Net income before federal taxes		$(3,348,615)
Federal income tax incurred		(221,095)
Net income (loss)		$(3,127,520)

Nodak Mutual Insurance Company
Reconciliation of Capital and Surplus Account
January 1, 1997, through December 31, 2002

	2002	2001	2000	1999	1998	1997
Capital and Surplus December 31, Previous Year	$26,806,492	$33,799,312	$35,526,236	$30,822,880	$24,875,038	$20,795,061
Net Income	(3,127,520)	7,431,254	3,079,209	1,827,094	5,645,888	98,637
Net Unrealized Capital Gains or Losses	(1,320,007)	(8,869,374)	(4,304,213)	2,680,444	368,572	2,907,199
Change in Net Deferred Income Tax	641,401	(210,440)				
Change in Nonadmitted Assets	637,760	(1,844,115)	(594,805)	216,017	(51,245)	1,039,177
Change in Accounting Principles		(3,500,145)				
Change in Excess of Statutory Reserves Over Statement Reserves			92,885	(20,199)	(15,373)	34,964
Net Change in Capital and Surplus for the Year	$(3,168,366)	$(6,992,820)	$(1,726,924)	$ 4,703,356	$ 5,974,842	$ 4,079,977
Capital and Surplus December 31, Current Year	$23,638,126	$26,806,492	$33,799,312	$35,526,236	$30,822,880	$24,875,038

Nodak Mutual Insurance Company
Analysis of Exam Changes
December 31, 2002

Description	Annual Statement	Per Examination	Surplus Change Increase	Surplus Change Decrease
Assets:				
Premiums and Agents' Balances in Course of Collection		$ 138,350	$ 138,350	
Accrued Retrospective Premiums		376,412	376,412	
Funds Held by or Deposited with Reinsured Companies	$ 1,553,290			$ (1,553,290)
Receivable from American Farm Bureau Insurance Services, Inc.		1,038,528	1,038,528	
Misc. Receivables		19,118	19,118	
Liabilities:				
Commissions Payable		$ 850,208		$ (850,208)
Other Expenses	$ 1,209,615	961,568	$ 248,047	
Unearned Premiums	20,445,720	19,770,812	674,908	
Advance Premiums		1,296,727		(1,296,727)
Ceded Reinsurance Premiums Payable	1,660,436	1,188,382	472,054	
Funds Held by Company under Reinsurance Treaties		472,054		(472,054)
Amounts Withheld or Retained by Company for Account of Others	4,204,266	4,282	4,199,984	
Remittance and Items Not Allocated		1,058,132		(1,058,132)
Payable to North Dakota Farm Bureau		199,953		(199,953)
Payable to Federal Crop Insurance Corp.		2,358,856		(2,358,856)
Total Examination Changes			$ 7,167,401	$ (7,789,220)
Capital and Surplus Per Annual Statement		$ 24,259,945		
Capital and Surplus Per Examination		23,638,126		
Decrease Per Examination		$ 621,819		

COMMENTS ON FINANCIAL STATEMENTS

<u>Bonds</u>

At December 31, 2002, all bonds were investment grade.

A custodial agreement is maintained with Community First National Bank for the protection and safekeeping of securities owned by the Company. A review of the agreement determined that it did not contain the following provisions recommended in the NAIC's *Examiners Handbook* which require banks or trust companies to:

1. Indemnify the insurance company for any loss of securities of the insurance company in the bank or trust company's custody occasioned by the negligence or dishonesty of the bank of trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damagne of destruction.

2. In the event there is a loss of securities for which the bank or trust company is obligated to indemnify the insurance company, the securitites shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

It is again recommended that the Company amend its custodial agreement with Community First National Bank to include all of the safeguards and controls required by the NAIC *Examiners Handbook*.

The Company calculates the amortization of bonds purchased at a discount to the call date rather than to the maturity date or call date which produces the lowest value. SSAP No. 26, paragraph 6, states that bonds containing call provisions shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).

It is again recommended that the Company amortize bonds purchased at a discount to the call date or maturity date whichever produces the lowest value.

<u>Stocks</u>

The Company did not submit forms for valuing Nodak Agency Incorporated, its wholly-owned subsidiary, with the Securities Valuation Office ("SVO") as required in the *Purposes and Procedures Manual of the SVO.* N.D. Cent. Code § 26.1-03-02.1 states that all securities must be valued in accordance with published valuation standards of the NAIC. Those publications include the *Annual Statement Instructions*, the *Purposes and Procedures Manual of the SVO* and the *Accounting Practices and Procedures Manual.* **It is again recommended that the Company submit forms for valuing Nodak Agency Incorporated with the SVO as required by N.D. Cent. Code § 26.1-03-02.1.**

In the third quarter of 2001, the Company sold 565 shares of American Agricultural Insurance Company common stock but did not file a report with the Commissioner or the NAIC disclosing the terms of the disposition as required by N.D. Cent. Code § 26.1-10.1-01. An insurer is required to disclose an asset disposition when the transaction is nonrecurring and involves more than five percent of the insurer's total admitted assets as reported in the most recent statutory financial statement. **It is recommended that the Company file a report with the Commissioner and the NAIC whenever an asset acquisition or disposition or change in ceded reinsurance agreement meets the materiality standards of N.D. Cent. Code Chapter 26.1-10.1.**

Real Estate

The Company did not properly report the capitalized costs of additions and improvements to real estate on Schedule A, Part 2 of the Annual Statement. The *Annual Statement Instructions* for Schedule A, Part 2, require that the actual cost of real estate acquired during the year include amounts for additions and improvements that have been capitalized. **It is recommended that the Company report real estate additions and improvements in accordance with NAIC *Annual Statement Instructions*.**

Funds Held by or Deposited with Reinsured Companies

The Examiners reclassified the following receivables reported by the Company under this caption in its 2002 Annual Statement.

Receivable from American Farm Bureau Insurance Services, Inc.	$1,038,528
Uncollected Premiums	138,350
Accrued Retrospective Premiums	376,412
Total	$1,553,290

The balance of this caption was $0 after the reclassifications made by the Examiners.

Miscellaneous Receivables

The Examiners reclassified a $19,118 miscellaneous receivable from a related party to this caption from “Other Expenses”. **It is recommended that the Company report assets and liabilities at net only when a valid right of setoff exists as provided in the guidelines set forth in SSAP No. 64.**

Losses and Loss Adjustment Expenses

This examination projected the Company’s reserves for gross and net unpaid losses for each line of business using standard actuarial estimation techniques. Developments were based generally on the Company’s own experience. All of Company’s lines of business were tested except special property (Part 1I), reinsurance – nonproportional assumed property (Part 1N), reinsurance – nonproportional assumed liability (Part 1O), and reinsurance – nonproportional assumed financial lines (Part 1P) as reported in Schedule P of the Annual Statement.

This examination projected the Company’s loss and loss adjustment expense reserves on a combined basis.

To develop estimates of ultimate salvage and subrogation recoveries, this examination looked at the historical ratios of recovered salvage and subrogation to paid loss and defense and cost containment (DCC), and projected these ratios to ultimate. This examination also performed a Bornhuetter/Ferguson calculation, using historical ultimate salvage/subrogation to paid loss and DCC as the "seed" ratio and selected ultimate salvage/subrogation to paid loss and DCC ratios using a combination of these two estimation techniques.

Upon reviewing all projections made of the Company's reserves for unpaid losses and loss adjustment expenses as of December 31, 2002, it was determined that the reserves as reported by the Company in its 2002 Annual Statement are within an acceptable range of possible outcomes. Consequently, the reserves reported by the Company have been accepted for purposes of this examination.

In reviewing loss adjustment payments, the Examiners noted that the Company did not classify loss adjustment expenses in accordance with NAIC *Annual Statement Instructions* and as a result it overstated defense and cost containment expenses and understated adjusting and other loss adjustment expenses. **It is recommended that the Company classify loss adjustment expenses in accordance with NAIC *Annual Statement Instructions*.**

Other Expenses

The Examiners reclassified the following items and amounts reported by the Company under this caption in its 2002 Annual Statement:

Commissions Payable	$850,208
Payable to North Dakota Farm Bureau and North Dakota Farm Bureau Trade Development and Service Corporation	199,953
Miscellaneous Receivables	19,118

Funds Held by Company Under Reinsurance Treaties

The Examiners reclassified a $472,054 reinsurance premium balance withheld by the Company under the terms of a reinsurance agreement with American Agricultural Insurance Company to this caption from the reported liability for Ceded Reinsurance Premiums Payable.

Unearned Premiums

The Company included advance premiums on business processed by the legacy system in the reported liability for unearned premiums at December 31, 2002, but it did not include advance premiums on business processed by the new system in unearned premiums and, as a result, it understated year end liabilities by $621,819.

In accordance with NAIC *Annual Statement Instructions*, the Examiner reclassified advance premiums totaling $1,296,727 to its separate caption.

Advance Premiums

The Examiner reclassified advance premiums of $1,296,727 from unearned premiums to this caption in accordance with NAIC *Annual Statement Instructions* and SSAP No. 53, paragraph 13. The Company did not report a liability for advance premiums in its 2002 Annual Statement.

Amounts Withheld or Retained by Company for Account of Others

The Examiners reclassified the following payables which were incorrectly included by the Company in the liability for Amounts Withheld:

FCIC Payable	$2,358,856
Remittances and Items Not Allocated	1,058,132
Other Expenses	782,996
Total Decrease	$4,199,984

It is recommended that the Company complete the Annual Statement with attention to all detailed instructions.

CONCLUSION

The financial condition of the Company, as of December 31, 2002, as determined by this examination is summarized as follows:

Admitted Assets		$71,498,975
Total Liabilities	$47,860,849	
Surplus as Regards Policyholders	23,638,126	
Liabilities, Surplus and Other Funds		$71,498,975

Since the last examination conducted as of December 31, 1996, the Company's admitted assets have increased $12,123,837, its total liabilities have increased $9,280,772, and its surplus as regards policyholders has increased $2,843,065.

The courteous cooperation extended by the officers and employees of the Company during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Rhoda Sautner, CPA, Pat White, CFE, Carole Kessel, CPA and Chief Examiner, and Mike Andring, ACAS, of the North Dakota Insurance Department participated in this examination.

Respectfully submitted,

David Weiss, CFE
Examiner
North Dakota Insurance Department

COMMENTS AND RECOMMENDATIONS

It is recommended that the Company's directors, officers, and key employees complete a conflict of interest statement on an annual basis and that the Company retain those statements for inspection for years subject to examination.

It is recommended that the Company file amendments to the Bylaws with the North Dakota Insurance Department as required by N.D. Cent. Code § 26.1-12-05, submit the proper filing fees required by N.D. Cent. Code § 26.1-01-07(5), and make the correct disclosures in the annual statement whenever it adopts amendments to the Bylaws or Articles of Incorporation.

It is recommended that the Company and American West Insurance Company enter into a management services agreement and that the terms of the agreement comply with the standards contained in N.D. Cent. Code § 26.1-10-05(1).

It is recommended that the Company modify the Facilities Services Agreement with the North Dakota Farm Bureau to specify all services and related consideration to be paid, in compliance with the requirements for related party transactions under SSAP No. 25 which indicate that amounts charged for services must be fair and reasonable.

It is recommended that the Company review all related party transactions for consistency with and adherence to the terms of existing legal agreements.

It is recommended that the Company comply with the disclosure requirements of SSAP No. 25 by properly completing Note 10 of the Notes to the Financial Statements in the Annual Statement.

It is again recommended that the Company increase its fidelity bond coverage to the amount suggested by the NAIC *Examiners Handbook*.

It is recommended that the Company make the following disclosures in its annual statement with respect to multiple peril crop insurance (MPCI) and the MPCI Partial Service Agreement with AFBIS:

- Report the unearned premium reserve associated with the multiple peril crop insurance program under Note 20 in the Notes to the Financial Statements as required by SSAP No. 78, paragraph 10.

- Report the amount of administrative expense payments received from the FCIC under Note 20 in the Notes to the Financial Statement as required by SSAP No. 78, paragraph 15.

- Report the direct premium written through AFBIS, a third party administrator, under Note 19 in the Notes to the Financial Statements.

It is recommended that the Company amend its reinsurance agreements by adding the "entire contract" clause to all agreements to which the Company is a party.

It is again recommended that the Company retain or be able to recreate detailed listings that agree with amounts reported in the Annual Statement.

It is recommended that the Company test its disaster recovery plan in 2003 and thereafter perform tests of the disaster recovery plan at least every 18 months.

It is again recommended that the Company amend its custodial agreement with Community First National Bank to include all of the safeguards and controls required by the NAIC *Examiners Handbook*.

It is again recommended that the Company amortize bonds purchased at a discount to the call date or maturity date whichever produces the lowest value.

It is again recommended that the Company submit forms for valuing Nodak Agency Incorporated common stock with the SVO as required by N.D. Cent. Code § 26.1-03-02.1.

It is recommended that the Company file a report with the Commissioner and the NAIC whenever an asset acquisition or disposition or change in ceded reinsurance agreement meets the materiality standards of N.D. Cent. Code Chapter 26.1-10.1.

It is recommended that the Company report real estate additions and improvements in accordance with NAIC *Annual Statement Instructions*.

It is recommended that the Company report assets and liabilities at net only when a valid right of setoff exists as provided in the guidelines set forth in SSAP No. 64.

It is recommended that the Company classify loss adjustment expenses in accordance with NAIC *Annual Statement Instructions*.

It is recommended that the Company complete the Annual Statement with attention to all detailed instructions.

SUBSEQUENT EVENTS

The Company's Board of Directors approved an $800,000 capital contribution to The Dakota Companies, L.L.C. at the February 21, 2003, Board meeting. The Company requested and received the Department's approval for the transaction.

The North Dakota Insurance Commissioner issued an Interim Order on March 20, 2003, determining that service fee and royalty payments made by the Company to the North Dakota Farm Bureau were not illegal and permitting the Company's Board of Directors to reinstate the fee payments through careful deliberation and arm's-length negotiations. The Commissioner recommends that the Board of Directors assess and articulate the bases for any future fee payments, that the presidency of the Company's Board and the North Dakota Farm Bureau Board be separately held, and that Interested Directors voluntarily abstain from voting on matters in which they have a material interest. Specifically, North Dakota Farm Bureau Directors serving on the Company's Board should not vote on matters directly affecting the Farm Bureau.

At a Special Meeting of Policyholders held on March 21, 2003, proposed amendments to the Company's Bylaws were adopted to restructure the Board of Directors and a slate of proposed candidates to serve on the new Board of Directors was elected. The changes to the Bylaws are summarized below.

Article III, Section 2 - This section designates the President and Vice President of the North Dakota Farm Bureau's Board to serve on the Company's Board of Directors and it provides for 10 directors to be elected from the following categories and for the following terms:

- Two members of the North Dakota Farm Bureau Board of Directors, other than the President and Vice President of that Board, will serve a two-year term.
- Three voting members in good standing of North Dakota Farm Bureau, who are not North Dakota Farm Bureau Directors, will serve a four-year term.
- Three policyholders who are non-voting members in good standing of North Dakota Farm Bureau will serve a four-year term.
- Two directors having business, insurance, legal and/or other training and/or experience beneficial to the Company will serve a four-year term.

No director may serve for more than eight consecutive years.

Article III, Section 3 - This section amends the provision for filling a vacancy on the Board and specifies that a vacancy will be filled by a new director who must meet the requirements for the directorship position.

Article III, Section 5 - This section is amended to require Board meetings not less than once every three months and to require two of these meetings to coincide with the North Dakota Farm Bureau Board of Directors meetings so that matters of mutual importance can be discussed.

Article III, Section 10 - This new section authorizes the Board of Directors to take action through unanimous written consent in lieu of a Board meeting.

Article III, Section 11 - This new section addresses the selection of a nominating committee to propose candidates for the Board of Directors.

Two senior members of the Company's management staff, the Chief Financial Officer and the Senior Vice President for Underwriting, resigned their positions in April 2003. The Company has since announced the appointment of Bruce Trost as Chief Executive Officer and has notified the Insurance Department that the position of Chief Financial Officer has been filled.

In May 2003, the Company was advised by its reinsurer, American Agriculture Insurance Company, of a potential overstatement of MPCI payments to the Company for years prior to 2003. The Company also received preliminary MPCI pool results for the year 2002 indicating a potential gain. No provision has been included in the financial statements at December 31, 2002, since the amounts of potential overstatement and gain are merely estimates and would offset to an immaterial net result.